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ABSTRACT

Vietnam has only recently emerged as a participant in the rapidly growing Asia Pacific economy, having rejected central planning in favour of a market driven economy by the late 1980s, and is now poised to become Asia's next economic "dragon". Its economic performance during the 1990s has been truly remarkable, with the growth of real GDP, consumer price inflation and export growth showing considerable, and sustained, improvement over that of the 1980s. This contrasts starkly with the experiences of other economies in transition, central and eastern Europe in particular, whose transition process has been considerably more difficult, with severe downturns in GDP growth and, in most cases, ruinously high rates of inflation. However China, another transition economy, has performed in general better than Vietnam in terms of both of these macroeconomic variables.

What makes this performance even more remarkable is that it has been achieved against a background of loss of foreign assistance from the former Soviet Union, a loss of cheap imports and the need to re-orientate its foreign trade due to the demise of the CMEA (Council for Mutual Economic Assistance), no substantive multilateral or bilateral assistance from the west until late 1993, and the US trade embargo, in existence since the end of the Vietnam war, which only ended in February 1994.

A crucial factor behind this recent economic resurgence of the economy has been the decision by the government to implement major economic reforms, in 1986 and later re-affirmed in 1989, which would transform the economy from being centrally planned to a market economic system. A key objective of this paper is, therefore, to identify the major economic reforms which have already been instigated and the macroeconomic performance of the economy since 1986, as well as its future economic prospects and challenges emphasising, in particular, the crucial contribution of foreign direct investment and overseas development assistance (ODA) in this process.

This paper was presented at the twenty-third annual meeting of the Midsouth Academy of Economics and Finance, February 7-10, 1996, Atlanta, Georgia, USA.

INTRODUCTION

Vietnam has only recently emerged as a participant in the most rapidly growing region of the world economy, the Asia Pacific economy. It is poised to become one of Asia's most vigorous market economies during the remainder of the 1990s and into the twenty first century, having rejected central planning, and is widely tipped to become Asia's next economic "dragon". Considerable interest in its development and future prospects have already been demonstrated by a number of economists and economic institutions (see for example World Bank (1993), Economist Intelligence Unit (1995), Quinlan (1995) and De Vylder and Fforde (1995) to name but a few).

Its recent economic performance has been truly remarkable. Real GDP growth was 8.7% in 1994, and is projected to be 8.0% during 1995, and averaged 7.4% over the extended period 1989-94. Consumer price inflation dropped from 67.6% in 1991, the highest since 1989, to 14.4% in 1994 and is projected to decline further to 12.7% for 1995[1]. Exports have also expanded rapidly in recent years, increasing at an average annual rate of over 30% since 1988, with rice production reaching a historical high in 1994 enabling the country to maintain its position since 1989 as the world's third largest exporter of rice. This contrasts starkly with the experiences of other economies in transition, central and eastern Europe in particular, whose transition process has been considerably more difficult, with severe downturns in GDP growth and, in most cases, ruinously high rates of inflation. In contrast China, another transition economy, has performed in general better than Vietnam in terms of both of these

1 This projection was made by the IMF in May 1995.

macroeconomic variables. However such a comparative analysis is beyond the scope of this paper.

What makes the performance of Vietnam even more remarkable is that it has been achieved against a background of loss of foreign assistance from the former Soviet Union, which at its peak amounted to $1 billion (US), a loss of cheap imports and the need to re-orientate its foreign trade towards Asia in particular with the demise of the CMEA (Council for Mutual Economic Assistance), effectively no substantive multilateral or bilateral assistance from the west until late 1993, and the US trade embargo, in existence since the end of the Vietnam war, which only ended in February 1994.

In spite of these successes Vietnam remains one of the poorest countries in the world, with a per capita GNP of around $220 (World Bank). Decades of war and economic mismanagement have left the economic infrastructure in very poor condition. In recent years over 1 million workers and soldiers have been released from the public sector, substantially increasing the ranks of the unemployed. However social indicators remain quite good for a country at the level of economic development which it has achieved.

A crucial factor behind this recent economic resurgence of the economy has been the decision by the government to implement major economic reforms, in 1986 and later re-affirmed in 1989, which would transform the economy from being centrally planned to a market economic system. A key objective of this paper is to identify the major economic reforms which have already been instigated and the macroeconomic performance of the economy since 1986, as well as its future economic prospects emphasising, in particular, the crucial contribution of foreign direct investment and overseas development assistance in this process.

BACKGROUND

In April 1975 communist controlled North Vietnam took control of Saigon, leading to the fall of the government of South Vietnam. The nation was officially reunified in January 1976, and in July of the same year the Socialist Republic of Vietnam was established. The reunification of the North with the South brought together two very different economic systems. The North with a state socialist centralised economic system, and that of the South with its decentralised market economic system. Initially, during the Second Five Year Plan (1976-80), the communist government attempted to impose the northern model on the South (the so called "transition to socialism")—collectivisation of agriculture, nationalisation of industries, state monopoly over trade etc., however as early as 1977 it was becoming clear that such a strategy was not working. Declining agriculture production in 1977 and 1978, indicative of a general deterioration of the economy, prompted the first steps towards reform which were initiated by the Sixth Plenum of the Central Committee in September 1979. This resulted in a number of piecemeal reform measures thereafter and over the course of the Third Five Year Plan (1981-85). The reform measures included giving private enterprise, predominantly based in the South, greater autonomy from the state, collectivisation of agriculture, subject to resistance in the South, was suspended, the introduction of a contract system giving households more freedom to sell their excess production in the open market, and finally individual households were allowed to cultivate land not in use by the cooperatives.

Economic performance improved noticeably over the Third Five Year Plan, however the economy still encountered a number of problems by the mid 1980s. These included a levelling off of agricultural production, exacerbated by renewed attempts to collectivise agriculture in the South in 1984, due to peasant farmers destroying their crops and abandoning the sector altogether. Inflation, however, was the biggest problem due primarily to food shortages and a rapid increase in the money supply. The latter primarily accounted for by the monetisation of the state budget deficits. Over the period September 1985 to September 1986 inflation rose to a ruinously high level of over 700%, prompting the government to accept the need for more fundamental reform measures.

ECONOMIC REFORM UNDER "DOI MOI" OR RENOVATION (1986-1989)

At the Sixth National Congress in December 1986 the government introduced a comprehensive reform program, with the objective of liberalising and deregulating the economy. The reform measures explicitly recognised the failure of central planning and marked a major turning point in the economic development of the economy. The objectives of the reform were:

1. to develop the private sector
2. to increase and stabilise agricultural output
3. to shift the focus of investment from heavy to light industry
4. to reduce the role of the state enterprises
5. to focus upon export led growth, based upon the experience of Vietnam's dynamic regional neighbours
6. to attract foreign direct investment, seen as essential for economic development.

After 1987 a number of the far reaching reforms were implemented, and this process was accelerated from 1989 onwards and into the 1990s, and included the following:

a. *Rural reforms*—the collective agricultural system was largely dismantled, with the focus on family farming on the basis of long term leases.

b. *Price liberalisation*—virtually all price controls were removed with the exception of fuel, electricity, transport and postal services.

c. *Devaluation*—the exchange rate was unified and sharply devalued. Foreign exchange trading floors were created which enabled the exchange rate to be largely determined by the market.

d. *Interest rate reforms*—interest rates were raised to very high levels, with the objective of making real rates positive, as part of the fight against inflation. After some initial success in reducing inflation in 1989, real rates of interest were allowed to become negative again and in 1990 and 1991 inflation returned. Since 1992 real interest rates have primarily remained positive, contributing to the sizeable decline in inflation thereafter.

e. *Fiscal reforms*—the government implemented measures to reduce the growth of public expenditure, including the demobilisation of the military (500,000 soldiers in total have been released) and the elimination of direct subsidies to state owned enterprises. Tax reform, in addition to the fortuitous revenue from petroleum operations, enabled the government to increase its revenues.

f. *State enterprise reforms*—included the elimination of direct budgetary subsidies from the government, and a further hardening of the budget due to the higher real interest rates which had to be paid for credit as previously identified. State enterprise managers by 1989 were no longer subject to the need to achieve centrally determined production targets, the influence of which had declined significantly since 1986, but had greater autonomy in determining where their output was sold and where input could be obtained from on the basis of market prices.

g. *Promotion of the private sector*—after many years of discrimination the government now actively promoted the development of the private sector, although its contribution to GDP is still small. Laws introduced for companies and private enterprises gave the once informal sector official sanction. This was identified further in the country's new Constitution (in 1992) which clarified the rights of the private sector.

h. *Financial sector reform*—this involved the restructuring of the banks, which dominate the financial system, into a two tier system with the State Bank of Vietnam performing the function of a modern central bank, and the four major state owned commercial banks providing banking facilities. The financial system is being further expanded to include shareholding banks, credit cooperatives and joint venture banks. Foreign banks have been allowed to operate since 1991 and the government is developing a securities market which is planned to be operative in 1996/97.

i. *Legal system reform*—arising from the creation of a market system is the need to develop the institutional structures necessary for its functioning. Of particular importance is the reform, or creation, of a legal framework to provide the framework for the operation of the market system, given the reduced direct involvement of the government. For example the introduction of a foreign investment law (1987), bankruptcy law (1993), environmental law (1993), land law (1993), and most importantly the 1992 Constitution which proclaimed individual rights and guaranteed against the nationalisation of foreign investments.

j. *Openness to direct foreign investment*—the government recognised the importance of direct foreign investment in the process of economic development, and a new investment law, with subsequent revisions, indicated the government's desire to attract such investment.

k. *Foreign trade reform*—this had been the monopoly of the state, but now firms both state and private were to have easier access to imports and more incentives to export. The latter aspect was clearly seen as being important, being based upon the export led growth of its dynamic regional neighbours in East Asia.

1. *Social reform*—the reform program was seen as likely to contribute to a transitional rise in unemployment, and in response to this likelihood the government initiated programs including retraining schemes and soft loans for the small scale private sector.

In essence *doi moi* is characterised primarily by its focus upon four key areas in particular—agricultural reform, price liberalisation and state enterprise reform, trade liberalisation, and foreign direct investment liberalisation.

Agricultural reform was regarded as a key constituent due to problems with inconsistent and unpredictable yields. In April 1988, under the guidelines of resolution number 10, farming cooperatives were no longer considered to be the centre of production. Instead, farm households became the essential production unit, with the cooperatives providing farm supplies, storage facilities and marketing arrangements. Membership of a cooperative became optional, and rights of full land use, inheritance, and transfer were recognised by the state. Long term leases were also extended, from 15-20 years for annual crops and 50 years for trees. These measures led to an immediate jump in farm output such that after facing near famine conditions in some parts of the country in 1988, Vietnam emerged as the world's third largest rice exporter one year later. These measures were supplemented by further agricultural reforms.

A second key area for reform is that of trade. Under the centrally planned system, external trade was tightly controlled by the government and it was focused towards that with the Soviet Union and Eastern Europe. All foreign trade transactions had to be channelled through central state trading corporations. Prices were administered by the government and targets were fixed for both imports and exports. Adding to the difficulty of trading was the maintenance of a complex system of multiple exchange rates.

To improve the country's trade performance the dong was devalued in early 1988, narrowing the spread between the official and parallel market rates. In 1989 a new tariff schedule was introduced, while quotas on imports and exports were lowered. The monopoly held by the central state trading corporations was eliminated when provincial and local authorities were allowed to establish competing foreign trade companies.

Complementing the deregulation of trade was the liberalisation of foreign direct investment, another key component of doi moi. New regulations governing foreign investment became effective in January 1988, and are considered to be some of the most liberal in Asia. All sectors of the economy, in principal, are open to foreign investors, although special incentives were attached to investments that promoted exports and generated hard currency earnings. Since the new foreign investment regulations came into effect, Vietnam has approved nearly $9 billion in foreign investment projects. However the number of projects actually carried forward has been less.

With the collapse of the Eastern bloc in 1989 the focus of the economic reforms has been placed upon the foreign trade regime as Vietnam is forced to seek new markets (including suppliers) to replace its Eastern bloc partners, and attention has been directed towards the dynamic economies of East Asia. To encourage exports exporters are allowed to retain 100% of their foreign exchange earnings and, completing a series of adjustments that began in 1987, the official exchange rate was brought into line with the free market rate and was thereafter to be set by the market. Export subsidies and a number of import duties and export taxes were also abolished.

THE ECONOMY IN THE 1990S

This section attempts to identify recent macroeconomic developments in Vietnam arising from the reform program previously outlined. In doing so emphasis is given to developments in GDP, savings and investment, consumer price inflation, the exchange rate, exports, imports and the current account over the period 1989-95 wherever possible.

The reforms have had a major impact upon the economy, and it is once again important to emphasise that these have been implemented without any substantive multilateral or bilateral assistance until late 1993. There was a significant initial improvement in the growth of real GDP in 1989 (see Table 1) arising from the further impetus of reform measures in this year and the further confirmation of the process of "doi moi", primarily due to a substantial increase in output in the agriculture and services sectors. These offset a sharp decline in industrial production arising from the loss of markets and cheap imports of inputs from the CMEA[2], the elimination of budgetary subsidies to the state owned enterprises, and the additional hardening of the budget for them with the imposition of positive real interest rates and loss of financial assistance from the former Soviet Union. During 1990-91 these external developments contributed to a downturn in the economy, which was very mild in comparison to the recessions being experienced in Eastern Europe at the time, with the growth of industrial production now overtaking that of the agriculture and services sectors (see Table 1). The period 1992-95 has since seen a rapid pick up in the growth of the economy, with the growth of industrial production leading the way. The growth of services production has also been strong, whilst that of agriculture has declined.

2 The CMEA was formally abolished in January 1991.

A major contributory factor behind the growth of output is domestic investment. In 1988 (see Table 2) total domestic investment accounted for 8.1% of Vietnam's GDP, of which half occurred through the state budget with foreign direct investment a paltry 0.5% of GDP. Thereafter total investment accrued steadily reaching 22.2% of GDP in 1994, of which only 6.6% took place through the state budget and the remainder coming increasingly from the domestic private sector and FDI. FDI accounted for 6.4% of GDP, a twelve fold increase over the figure in 1988.

To fund such investment, and hence growth, the need for domestic savings and access to foreign savings becomes imperative. In 1988 domestic savings were negative and domestic investment had to be funded from foreign savings, primarily financial assistance from the Soviet Union (see Table 2). Thereafter, as a result of the confidence engendered by the further reforms from 1989 in terms of recognition of private sector rights, reduced inflation, banking sector reforms and positive real interest rates, domestic savings displayed a remarkable transformation rising steadily from a figure of 5% of GDP in 1989 to 16.6% in 1994. The contribution of foreign savings declined during the period 1989-92, but increased again in 1993 and 1994. Such sources of savings will be crucial for Vietnam to fund its desperately needed investment and growth.

Tables 1 and 2 give a useful insight into Vietnam's incremental capital-output ratio (ICOR), which suggests that the growth rates achieved over the period 1992-94 were achieved with an ICOR of between 2-2.5. Other countries such as South Korea maintained an ICOR of around 2.5 in the 1960s and 1970s, during the early stages of its industrialisation. However this is unlikely to be maintained, and the government has forecast that this will rise to around 3 by the year 2000. This suggests that if Vietnam is to maintain real growth rates of GDP at around 8%, investment as a proportion of GDP will need to be around 24%. Hence domestic savings will need to increase (both in the public and private sectors), and Vietnam will be dependent upon foreign private sector savings and ODA for some time to come to make up any deficiency.

The ICOR figure of 3 by the government has itself been questioned. The case of Indonesia may provide a useful example. Its ICOR was well above 5 in the early 1980s as growth rates fell in response to austerity measures. During 1984-88 it fell to 4.6 and then 4 during 1989-93, but has since risen to 5 again. China has grown more rapidly than Vietnam, but with an ICOR of about 4 it has taken very large investment flows to achieve its rapid growth. The World Bank has pointed out that if Vietnam's ICOR were even 3.9 in 1997 instead of 3, and the level of current investment remained the same, GDP growth would fall from above 8% to around 4% in that year.

Consumer price inflation (see Table 3) abated considerably in 1989 to 34.7% from 394.0% in 1988 (World Bank), however further monetisation of the budget deficit in 1990 further fuelled inflation. The authorities were determined to crack down on inflation, however, and from 1991 the budget deficit was no longer monetised. Since then inflation has come down noticeably with the exception of 1994, in which inflation shot up mainly due to the increase in food prices arising from the summer floods in the Mekong Delta.

There were a series of currency devaluations in 1989, when the official rate of the Dong was brought down from D386:$1(US) to the then black market rate of D4200:$1(US). The currency continued to fall again by mid 1990 reaching a low of D14500:$1(US) in November 1991, but then appreciated to D10800:$1(US) by the following August (see Table 3). Since this time government intervention through the State Bank of Vietnam and unusually large inflows of dollars, has maintained the rate at around this rate since. The authorities are keen to maintain the stability of the local currency as part of its efforts to stem the dollarisation of the economy. With this objective in mind a decree limiting the use of foreign currency in everyday transactions came into force in October 1994. On the other hand exporters have been calling for some time for a steeper depreciation of the dong against the dollar, to allow them to maintain competitiveness.

Until the reforms of 1988-89, Vietnam's recorded exports covered only between one-third and one-half of imports. Even before the reforms exports, increasingly, were going to the convertible currency area (non CMEA countries, particularly in Asia), although most imports continued to come from the non convertible area (CMEA). An approximate balance between convertible and non convertible exports was reached around 1987. The chronic trade deficits were largely covered by grant aid and highly concessional credits from the former Soviet Union. The collapse of the communist regimes of Eastern Europe from 1989 caused the gradual loss of those countries' markets and commodity assistance, resulting in their almost complete disappearance in 1991 when the CMEA was formally wound up and the Soviet Union disintegrated. The reforms to the trade and foreign exchange regimes of 1988-89, and Vietnam's emergence as an exporter of rice and crude oil, generated a compensating increase in exports to the convertible area (primarily Japan, Singapore, Hong Kong, Taiwan and South Korea, but also increasingly Western Europe). In dollar terms merchandise export earnings increased by 87% in 1989, and grew at an annual average rate of 23% in the six years to 1994. However, even after several years of rapid growth merchandise exports still represented only around 20% of GDP and in 1994 were worth less than $50(US) per head, well behind that of Thailand ($750(US) per head) and Indonesia ($199(US) per head).

In 1994 there was a significant shift in the composition of Vietnam's exports (see Table 5) as textiles and garments overtook sea products and rice to become the country's second largest export earner after oil, and shoes also moved into the top ten earners. Vietnam's prospects as a low labour cost exporter of labour intensive manufactures will improve as it becomes integrated in the East Asian and west European markets. Textile and garment exports increased in 1994 by 57% to $550 million, largely on the basis of increased sales to Western Europe which absorbed about half of the total. Because it is denied Most Favoured Nation (MFN) status, Vietnam is effectively excluded from what it sees as potentially the largest market for its textiles, the USA, despite the lifting of the trade embargo in February 1994.

In terms of Vietnam's overall current account performance (see Table 4), the traditional deficit is likely to increase in the future on the basis of the trade pattern which is already beginning to emerge. Strong export growth is usually outpaced by an even stronger and largely investment related import increase. There is likely to be a further deterioration of the invisibles balance, as indicated by developments in 1993 and 1994, arising from increased net outflows of interest, profit and dividends. However this is being offset by increasingly higher transfers, both public (in the form of grant aid) and private, boosted by increased remittances from overseas Vietnamese (Viet Kieu), whose attachment to the homeland is being actively, and successfully, encouraged by the government. In addition it is expected that the invisibles balance deficit will be reduced by growing tourism receipts. Tourist arrivals topped 1 million in 1994, a threefold increase over 1991, and the government is hoping that 3 million tourists per year will visit Vietnam by the year 2000.

Vietnam is strategically placed in the most dynamic region of the world economy, although, as observed earlier, it is considerably economically backward by comparison with some of its neighbours. After the second world war, in East Asia, Japan became the first of a series of countries to rapidly develop, to be followed in the 1960s and 1970s by Hong Kong, Taiwan, South Korea and Singapore and then in the 1980s and 1990s by another wave consisting of Malaysia, Thailand and Indonesia. Another group of countries, for a variety of reasons, such as the Philippines, Myanmar and Vietnam itself, missed out on the economic success of their neighbours. Whilst Vietnam is entering the developmental process relatively late, it is at least able to derive lessons from the experiences of its newly industrialised, or industrialising, neighbours (NICs). The economic success, for instance, of South Korea, Singapore, Taiwan and other countries in the region was largely based on, and facilitated by, a number of key variables, including: a strong central government with relatively honest and competent civil servants managing the economy; extensive land and agricultural reform; a strong emphasis on education; a high savings and investment rate; openness towards foreign trade (exports) investment and technology; declining population growth rate; macroeconomic stability.

How has Vietnam fared relative to such developmental criteria. Whilst political power is highly centralised in Vietnam economic power is highly decentralised (the importance of provincial and local governments are relevant here), and civil servants are underpaid and not well educated in the ways of a market economy. A key component of the reforms has been directed towards the agricultural sector and these have proved to be very successful as alluded to previously. During the period of central planning high priority was given towards health and education, however recent cuts in government expenditure have caused these areas to suffer. Whilst Vietnam has a high literacy rate (90%) and 100% primary school enrolment, its educational system and technical training facilities have deteriorated significantly over the past decade. Domestic savings have improved and this is facilitating more investment, however the financial system needs to be developed further to ensure that domestic savings for productive usage is expanded further. Since the late 1980s Vietnam has become increasingly open to foreign trade and investment, having some of the most liberal foreign investment laws in Asia for example. Macroeconomic stability is being achieved, as indicated in a previous section, however the population growth rate still remains too high (2.1%).

Vietnam has made, therefore, some headway in regard to achieving desirable outcomes in regard to the growth criteria. However it is also clear that while lessons can be learned from the experiences of the older NICs (Korea, Singapore and Taiwan) it is also clear that economic circumstances have changed in the 1990s, with increased economic integration in regard to trade and finance suggesting that a policy of strong government intervention in the economy, adopted by these countires, may no longer be appropriate or possible. Hence the more recent experiences of Malaysia, Indonesia and Thailand may be more appropriate.

Vietnam has become more integrated into the world economy through a combination of foreign direct investment and foreign trade. With its recent membership of ASEAN[3] it has become a natural trading and investment partner of the emerging South-East and East Asian bloc. This region tends to favour a free trade rather than protectionist outlook, which will reinforce the tendency for Vietnamese international economic policy to be strongly, if not radically, free trade in its orientation.

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3 In July 1995.

Because the world economy in the 1990s is vastly different from that of 1950-70 and Vietnam's internal circumstances are also significantly different from those of the older NICs when their growth spurt began, Vietnam will have to follow its own path. Its late emergence to the capitalist economic scene implies that Vietnam must simultaneously undertake four transformations: agricultural renovation, reconstruction / construction of its basic infrastructure, develop import substituting industries, and expand the export of manufactured goods. This contrasts with the NICs who were able to go through each of these in discrete stages.

Agricultural renovation in Vietnam has two chief tasks: raising the productivity of the sector's existing resource base, and secondly to expand the base into hitherto neglected areas such as fruit and vegetable growing and livestock rearing. However agricultural renovation will also be important for the generation of savings, foreign exchange and surplus labour, which will assist in the process of industrialisation. This will result in a higher demand for consumer goods encouraging the development of rural industries such as agro-processing and handicrafts, which will provide jobs for the work force made redundant after the productivity gains in agriculture.

Considerable construction, or reconstruction, of the economy's infrastructure will be required after decades of war. Roads, bridges, ports, railways and airports need upgrading and extending, and especially in the rural areas. Housing and other urban infrastructure need major investment. Major expenditure is also required in education, health and the protection of Vietnam's fragile environment.

Vietnam is also seeking the creation of import substituting industries, for the following reasons. Firstly, to meet the growing domestic demand for consumer durables, building materials and industrial inputs arising from increased incomes in the agricultural sector. Secondly, to make better use of the country's natural resource endowment, and thirdly to improve the trade balance. Higher domestic savings would provide some of the funds to invest in these industries, but foreign capital would also be available particularly from countries with their own heavy and labour intensive industries to export. The government would offer protection for these infant industries in the form of tariff barriers, cheap credits, and subsidies to keep wages low. However it is necessary to distinguish between what the Government might like to do and what it can do. The government appears to be trying to encourage import substitution to the extent that it can, however, the policy options for the Vietnamese government, and the international environment, are significantly different from those faced by countries such as South Korea and Taiwan in the 1960s. With regard to product markets, Vietnam is effectively unable to control its borders and thereby control imports. Additionally, international private capital flows are far more significant and more mobile than in the past. Hence Vietnam will need to create an environment that is seen to be attractive to foreign investors when compared with other countries.

The final component of the development strategy is the development of export oriented manufacturing. Until recently Vietnam's export growth was heavily based on primary commodities. In 1994 there was both growth and diversification as garments, in particular, found a lucrative market in the European Union. This is a trend which has been encouraged by the government, meeting with a ready response from the older and newer NICs looking for places in which to relocate their labour intensive industries. The country has an advantage in having a highly motivated low cost workforce, preferential access to certain markets and a government keen to develop export processing zones (EPZ) which are ideal for small scale manufacturers not interested in developing backward linkages into the economy. Foreign direct investment has largely been in export oriented areas, where investors can circumvent Vietnam's weak physical and institutional infrastructure. The EPZ's offer a free trade environment, access to infrastructure and even better incentives than are on offer elsewhere.

PROBLEMS AND CHALLENGES FOR THE FUTURE.

Despite its recent successes, the ability of the government to maintain a fast rate of economic growth and development, and to be Asia's next newly industrialised country, will require the country to successfully address the following key challenges.

1. *Deploy its resources effectively*
   the nation needs to utilise its scarce resources efficiently, requiring raising productivity levels in the agricultural sector, utilising the entrepreneurial flair of southern businessmen, encouraging overseas Vietnamese to invest locally, merging viable state enterprises with private investors and utilising overseas development assistance (ODA) well.

2. *Create equitable wealth*
   as a strategic priority, for both political and social reasons, the country needs to narrow the gap between the "haves" and the "have-nots" during the process of economic development. The country's average per capita income is roughly $220, although in some parts of the country income levels are twice the national average (e.g. Ho Chi Minh City).

3. *Control the rate of population growth*
   Vietnam is a poor country which is likely to remain impoverished until it is able to control the growth of its population, which is currently standing at 2.1% a year. The 1.5 million annual increase in population serves to put further

strain on the limited resources of the state, and to put severe pressure on the nation's resources.

4. *Create employment*
   the recent loss of employment in the military, amounting to some 500,000, and in other areas of the public sector such as the state owned enterprises, 800,000, has contributed to stubbornly high levels of unemployment. In combination with substantial under employment in the rural areas, this situation presents a major problem to the government. The ability to maintain political stability, and the formation of a consumer class providing the foundations for further industrialisation, will require the government to bring about the creation of jobs across the broad spectrum of society, ranging from peasant farmers to university graduates.

5. *Maintain sound economic management of the economy*
   the attainment of a stable macroeconomy is a key prerequisite for further economic development of the economy, as clearly evidenced by the experiences of its dynamic economic neighbours. This will create the necessary environment for the market based economy to perform effectively, by stimulating savings and investment, including the attraction of foreign investment, and maintaining international competitiveness through maintaining a low rate of inflation. To achieve this will require control over the budget deficit and monetary growth, the need to reduce the large foreign debt and to effectively utilise the large capital inflows from international development agencies.

6. *Invest in human capital and physical infrastructure*
   there will be a pressing need for Vietnam to invest in the education of its people and also in its physical infrastructure.

Whilst Vietnam has plenty of cheap labour, this will not be enough when it eventually hits shortages in trained and skilled workers. As discussed earlier Vietnam's infrastructure is also very dilapidated, and with limited domestic resources the country will need to get access to, and use well, international aid and assistance to upgrade its infrastructure.

7. *Creation of strong and efficient institutions*
   Vietnam lacks the necessary institutions to support a market oriented economy, which will have a detrimental effect, if not tackled sufficiently quickly, upon the long term development of the economy. It needs to develop a modern Central Bank, an independent judiciary, a modern banking system and supportive capital markets for the fledgling private sector. Measures have already been taken to improve these but they are still deficient on many fronts.

8. *Reduce its reliance on primary exports (oil, rice and seafood products)*
   Vietnam remains exposed to fluctuations of world commodity prices, given its heavy export dependence upon crude oil, sea products and rice, which accounted for 52% of total exports in 1994. Manufactured exports, supported by foreign direct investment, will be required to make a larger contribution to external trade in the future. Of particular importance will be the development of exports of textiles and garments, and electronics. Progress has been made in the former as well as that of shoes, but the development of the electronics industry is still at a rudimentary level.

9. *Prevent the North/South, and rural-urban split from widening*
   the gulf between the north and south of Vietnam, as a result of history, politics and economics, threatens to become even

more pronounced as free market reforms take root. Ho Chi Minh City is destined to become Vietnam's leading commercial centre and international focal point. In order to prevent regional disparities the government will need to divert more investments to the north and other underdeveloped provinces. In addition growing income differences between the rural and urban population would trigger off urban migration, which has the potential for serious disruption and instability.

10. *Maintain political stability*
    whilst economic reform has been a key component of the developmental program, political reform, or pluralism, is not on the agenda. The coexistence of these two inherently conflicting principles is a gamble, as in the case of China, which the government is prepared to accept.

CONCLUSIONS

The recent economic performance of the Vietnamese economy during its recent transition to a market economy has been remarkable, with significant progress having been made in terms of real GDP growth, savings and investment, inflation and export growth to name but a few. Little multilateral or bilateral assistance has been provided to the country during the period of its economic reforms, and it has also had to adjust to the loss of financial assistance from the former Soviet Union and the need to reorientate its trade towards the dynamic East Asian economies. A similar transition process has been conducted in Eastern Europe with traumatic initial, and for some continuing, consequences for output, employment and inflation, which Vietnam has largely been successful at avoiding. However Vietnam has only completed the first stage in the process of economic development, in which the existing slack within the economy is being more fully utilised. The next stage will be more difficult, requiring the need to improve the efficiency and productivity of its fledgling market economy. Such will require the need to improve the structure and institutions upon which the economic system is based. If scarce resources are not utilised efficiently and bottlenecks arise, the process of economic development will come to a halt.

The tasks facing the authorities are many, however there is much ground for optimism, despite the enormity of these, and Vietnam is well placed to become the next Asian economic dragon.

Table 1	ECONOMIC GROWTH 1989-1995					
	REAL GDP (%)		GROWTH BY SECTOR (%)			
		Agriculture	Industry	Manufacturing	Services	
1989	7.60		7.00	-2.80	-4.00	15.40
1990	5.10		4.90	6.00	10.70	5.30
1991	6.00		7.00	9.10	9.90	3.30
1992	8.70		7.20	14.00	14.60	7.00
1993	8.10		3.80	13.10	12.10	9.20
1994	8.80		3.90	14.10	13.90	10.10
1995	*8.00					
Ave. 1989 -1994	7.40		5.60	8.90	9.50	8.40

* IMF estimate

Source: Central Institute For Economic Management, Hanoi

Table 2

SAVINGS AND INVESTMENT* (% OF GDP)

	1988	1989	1990	1991	1992	1993	1994
Total Domestic Inv.	8.10	9.10	11.40	15.00	17.60	20.50	22.20
of which:							
Budget	3.90	6.30	6.50	3.50	6.30	7.30	6.60
Non Budget	3.70	2.30	4.90	11.50	7.30	7.90	9.20
FDI	0.50	1.20			4.00	5.30	6.40
Domestic Savings	-2.40	5.00	6.80	10.10	13.80	14.80	16.60
Foreign Savings	10.50	4.80	4.60	5.10	4.10	6.20	8.10

* Savings may not equal investment in all cases because of statistical discrepancies in the underlying data

Source: World Bank, Vietnam Economic Report; Vietnam: Transition to the Market; Central Institute for Economic Management.

Table 3 Consumer Price Inflation (%) and the Exchange Rate

Year	CPI (%)	Exchange rate*
1989	34.70	4,000.00
1990	67.50	5,200.00
1991	67.60	9,750.00
1992	17.50	11,500.00
1993	5.20	10,750.00
1994	14.40	10,900.00
1995	**7.00	***11,044.00

* The number of Dong to the Dollar (US)

** IMF estimate

*** Latest Figure Available

Source: State Prices Committee, Hanoi

Table 4	Current Account ($m)					
	1989	1990	1991	1992	1993	1994*
Merchandise Exports	978.00	1,256.00	2,010.00	2,581.00	2,989.00	3,600.00
Merchandise Imports	-985.00	-1,208.00	-2,218.00	-2,541.00	-3,879.00	-4,500.00
Trade Balance	-7.00	48.00	-208.00	40.00	-890.00	-900.00
Invisibles Balance	-220.00	-330.00	-247.00	-99.00	-576.00	-813.00
Net Interest, Profit and dividends	-208.00	-238.00	-231.00	-287.00	-384.00	-580.00
Net other Services	-12.00	-92.00	-16.00	188.00	-192.00	-233.00
Net Public Transfers	0.00	127.00	110.00	64.00	194.00	200.00
Net Private Transfers	9.00	34.00	67.00	59.00	68.00	250.00
Current - Account Balance	-218.00	-121.00	-278.00	64.00	-1,204.00	-1,263.00

* Official and Economist Intelligence Unit (EIU) estimates

Source: World Bank, Vietnam: Transition to the Market; EIU

Table 5	Leading Exports ($m)		
	1992	1993	1994
Crude Oil	805.00	861.00	976.40
Textiles & Garments	221.00	350.00	555.00
Sea Products	307.00	370.00	480.00
Rice	418.00	350.00	405.70
Coal	62.00	84.00	114.70
Shoes	16.00	24.00	100.00
Coffee	91.40	85.00	97.50
Rubber	67.00	70.00	70.00
Cashew Nuts	41.40	31.30	60.00
Peanuts	32.00	46.70	45.00
Source: Ministry of Commerce			

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